RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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THE MARKET: Every week I read about business and economics until I'm blue in the face. If you read Fortune or Business Week or Barron's or Financial World, you will absorb so many opinions and expert forecasts that your head will spin. And most of the forecasts will be reasonably professional, backed by statistics, knowledge and lots of impressive work. They're fascinating reading. But are they of any use? I honestly don't know.

I'm a voracious reader, as most of my subscribers know by now. But let me tell you one thing. If I didn't have the stock market averages to go by, I'd have packed up my bags and chucked this business long ago. Furthermore, I would never have had the nerve to do any investing for myself or for my family. The reason? Investing without an intimate knowledge of the markets (and more specifically, without a knowledge of the PRIMARY TREND) is like sailing an ocean liner without a compass.

I've said this ever since I started writing these reports back in 1958: We must know one thing before we spend our hard-earned money on IBM or GM or Con Ed or any other stock. And that is the DIRECTION OF THE GREAT PRIMARY TREND OF THE MARKET. It's the primary trend that will ultimately make you or break you in this business. Buy any 20 reasonably good common stocks in a bull market, and you're going to show fat profits on balance before the bull market is over. Buy the 20 best stocks that your research can come up with during a primary bear market, and I'll guarantee that you'll wish you never heard of Wall Street before that bear market is over.

I've discussed repeatedly how bull markets end. They end in exhaustion, and the signs of exhaustion are as follows: rampant speculation, spike moves in the low–priced stocks, standing-room-only at the brokerage offices, minuscule yields on stocks, rumors and rumors about rumors, and in general an atmosphere which says, "stocks can't go down" and "this time it's different" and "we're in a new era." Is this where we are now? I don't think so. I could be wrong, but I really don't think we're there.

What I described above is the atmosphere, the climate that prevails when a big bull market is breathing its last. But there is also a Dow Theory FORMATION that identifies the end. It's called a bear signal, and it works like this. First there is a full–fledged secondary reaction in BOTH the D-J Industrial and Transportation Averages. Then there is a rally. If that rally fails to take BOTH Averages above the preceding highs we watch carefully. Following the failed rally the Averages turn down. This is where we watch VERY carefully. If that second decline takes BOTH Averages below the preceding reaction lows (preferably on increasing volume), we're looking at a bear signal and a primary bear market.

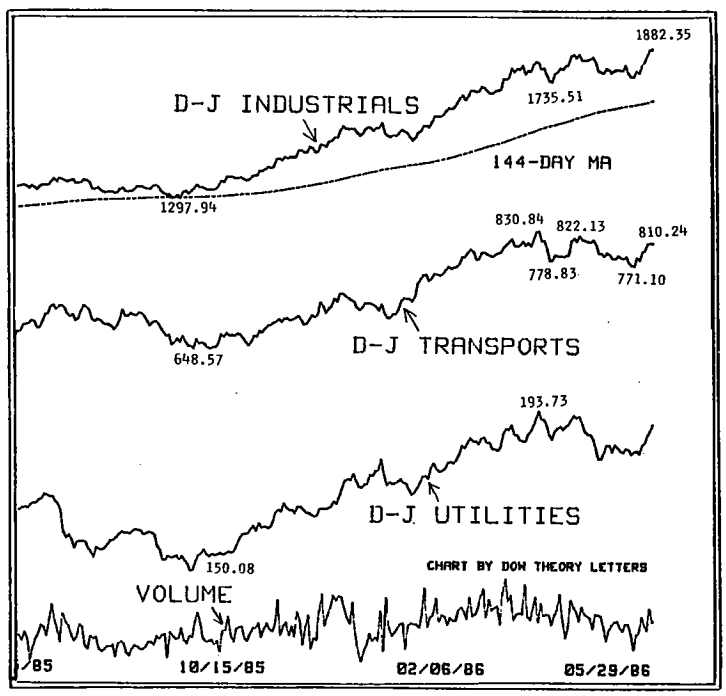
In recent Letters I stressed two points on the D-J Averages. Those two points were the 1735.51 Industrial low of April 7 and the 778.83 Transport low of April 7. I wrote that if BOTH of those lows were violated, we could consider the secondary trend of the market to be down. Now let's see what actually happened (page 1 chart). Note that on the recent decline the Transports did break their 778.83 low. They broke that low by about 7 points, halting their decline at 771.10 on May 7. But far more important was the fact that the Industrial Average refused to confirm. On May 19 the Industrial Average halted its decline at 1758.18-- a full 23 points ABOVE its April 7 low.

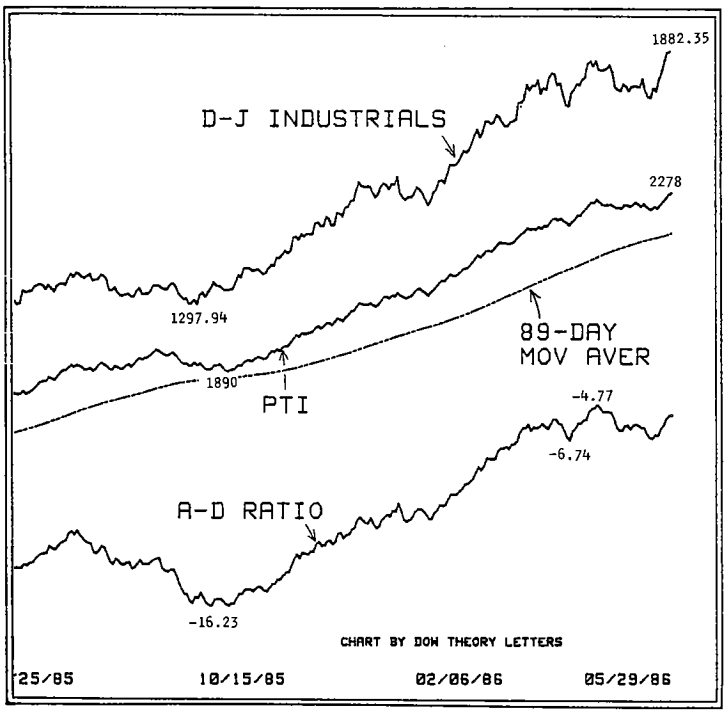
It should therefore have come as no surprise to my subscribers that following that bullish non-confirmation the market rallied strongly. By May 29 the Dow was back over 1800 again. On May 28 the Dow closed at a new record high of 1882.35, it's third major new high since early March.

Note on the page 1 chart, however, that the latest record Dow high was again accompanied by a Transport non-confirmation. The fact is that against three consecutive Dow highs we have witnessed three descending peaks in the Transports: 830.84 on March 31, 822.13 on April 21 and 810.24 on May 28. We'll have to watch this divergent pattern carefully, because it could lead to trouble.

On the constructive side, my PTI (see page 2 chart) on May 27 recorded a new bull market high of 2276. That action was followed by a broad rally in the general market, a rally which by May 28 saw almost ALL the major averages and indices hit new bull market highs. New record highs on that day were recorded by the Dow, the NYSE Composite, the S&P 500, and both the NASDAQ and AMEX Indices. That's pretty impressive and certainly indicative of primary bull market action (I keep stressing that last point).

While I am at it, I want to go over one concept again. This is a concept that is so IMPORTANT, SO FUNDAMENTAL--that I wish subscribers would read the following paragraph three times over—or 10 times or as many times as it takes to get it firmly in mind.





Here's the concept: AS LONG AS THE PRIMARY TREND IS BULLISH, THE INVESTOR MUST ACCEPT ALL HESITATIONS, ALL SIDEWAYS MOVEMENTS, ALL CORRECTIONS, AND CERTAINLY ALL DOWNSIDE NON-CONFIRMATIONS IN THE AVERAGES--SIMPLY AS INTERRUPTIONS IN THE BULL MARKET. It is well to remember that interruptions in a primary bull market act like pressure on a steel spring that wants to expand! Thus, when the bull forces finally express themselves again (as they will), amateur observers are invariably flabbergasted and newspaper reporters will search wildly for "the reason" for the advance. The reason is always the same. It's still a bull market, and the counter-bullish forces have spent themselves. Furthermore, the longer the primary trend (in this case the bull trend) is held back, the greater the ensuing rise.

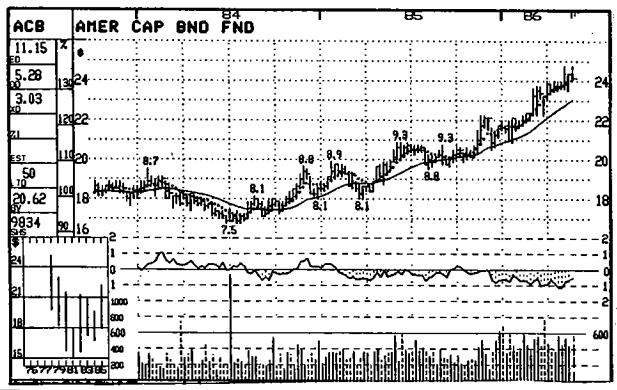
* *

As an aside, I note that many analysts are pooh-poohing the record numbers of odd-lot shorts that have appeared recently. On top of that, the latest NYSE figures for round-lot shorts also show a new record high. Given that a lot of these short sales may represent arbitrage, I am nevertheless of the opinion that the record number of shorts in both areas indicate a rising tide of bearishness within a confirmed bull market. In my book, that's bullish. There is, in fact, NOTHING MORE BULLISH than a rising level of skepticism within a primary bull market. And that, I believe, is where we are today.

INVESTMENT POSITION: The bull's in the box, and most of the major Averages on May 28 shot to record highs. But I still feel (based on the relationship of the Dow and its moving average--see page 1 chart) that this market is getting ahead of itself. I'd like to see it rest for a while. In the meantime, I'm sitting with all my positions and watching the show. It's a bull market, and in a bull market values INCREASE THROUGH TIME. That's why we SIT.

Notes on Dow stocks: DuPont acting consistently better than the market. Chevron and Exxon showing improving relative strength (RS). MacDonalds and Merck steadily rising RS. Philip Morris one of strongest Dow stocks. United Technologies now turning down in RS. Woolworth continues to be a winner, and for the first time in its long history Z's specialty divisions are now grossing more than the variety stores. Woolworth continues to be one of my favorites.

Can you make money with bond funds? You bet, and this chart (courtesy of Mansfield) proves it. Here's ACB, the largest of the closed-end bond funds (NYSE), moving from its 1984 low of 16 3/4 to a recent high of 24 7/8. With a 2.20 dividend, ACB was yielding 13% at its low. At its recent high, ACB had risen 47% from its '84 low. Adding 47% to two years of 13% return gives us a two-year total return of 73% or 36% a year. That's not half bad from a stodgy bond fund. This is a fund, by the way, that I've recommended repeatedly. You can still buy it, but if you do--average into it—in other words, buy so much every month or so. By the way, if you want monthly income there's only one fund that will give it to you and that's Intercapital Securities (another NYSE bond fund).

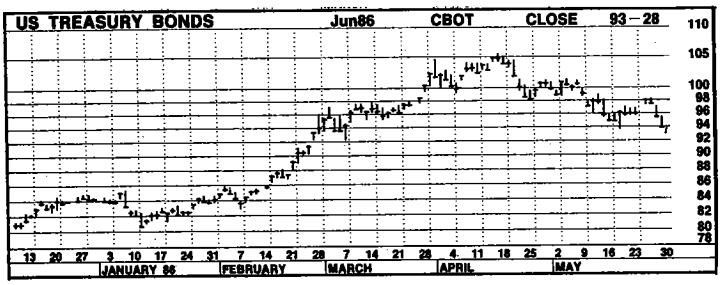


MAXWELL: Charles Maxwell is the senior energy strategist at Cyrus J. Lawrence, and he is generally conceded to be one of (if not THE) best energy and oil analyst in the nation. I have just received Charlie's report of May 16, and in view of what I wrote in the last Letter ("Russell's Big Picture") I thought the following "glimpse into the future" from Maxwell's report was rather fascinating:

Continued sluggishness of the Soviet economy, and the recognition by Russia's leaders that this is not a time to enter into a spending contest with the US in a "Star Wars" type of competition, leads to a series of disarmament agreements in the West. It becomes a common perception that the Bear is pre-occupied with his own internal problems and is not likely to be active internationally. The Russians reduce support for terrorist groups, they negotiate a withdrawal from Afghanistan, and they yield a bit more breathing room to Poland. The Americans embrace the disarmament concept quickly, and military expenditures throughout the West begin to fall quickly. This leads to lower deficits, lower inflation, lower interest rates, and eventually a pickup in economic growth. As a consequence, Western stock and bond markets break out on the upside with record performances beyond all historical norms. It is an era of rising confidence based on assumed rapprochement between East and West. Fiscal and monetary policy exhaustion has done what reason could not previously accomplish--bring the two sides together.

All this out of Chernobyl? Of course, it is too much to expect. But such developments as we have outlined above remain intriguing possibilities to watch.

BONDS, RATES: Most investors do it all wrong when it comes to bonds. Bonds should be looked upon as safe sources of fixed income. You have three problems with bonds. (1) Safety, so I suggest AA-rated bonds or good bond funds. (2) Second problem is the call feature, so you just buy the bond with the best or farthest out call (some bonds are not callable), or buy older bonds at a discount so they are less likely to be called. (3) The rates are a problem, so when are the rates right? The rates are right when bonds are rising and rates are falling (don't laugh). But since few people are smart enough or gutsy enough to buy the great bond



bottoms (like 1981 or 1984) I usually suggest averaging into bonds. String out your purchases and buy bonds with the thought that you are going to hold them to maturity (or will 'em to your kids). Anyway, that's the way I buy them.

Where are bonds and rates now? This chart from Investor's Daily tells us that bonds are now in a definite downtrend following their fantastic rise from the '84 lows. How big a correction are we facing? Who knows? I don't and neither does Henry Kaufman. If the June Treasury contract (shown here) breaks under 94, then the bonds will surely test the 90-92 area (which is where I thought they were going all along).

If you haven't bought any bonds so far, rejoice. As they used to say about the stock market in the dark days of 1973-74, "Yields are rallying." Why are bonds going down now? Two reasons: the first is that the economy is now heating up with the latest "leading indicators" index up a big 1.5% (remember I said that I have never seen a stock market move as big as this one without an ensuing boom in the economy). Secondly, the bonds are way overdue for a correction, and the perception of a coming business boom is triggering that correction.

UTILITIES: If a new tax bill goes through with its lower top rates, then straight income is going to be worth more. One of the better areas for income is the utility stocks. I have been writing about the water utilities for a couple of years, but there are many other utilities that now qualify as income vehicles. In many cases these utilities are going to experience declining levels of debt and rising levels of cash flow.

I haven't got room here to list the many pluses of each of these utility companies, but suffice it to say that I like all the companies on the following list: Consolidated Edison, Duke Power, Ipalco, Kansas Power & Light (NOT to be confused with Kans. City P & L), Minnesota Power, Northern States Power, Potomac Electric, Teco Energy, Tucson Electric, Wisconsin Public Service. Suggestion: buy a list of at least five of these companies, and I don't care if you buy 10 shares of each or 500.

ROAD TO RICHES: I've been stressing in these reports that in order to make real money (in the stock market or anywhere else) you've got to have a plan, a definite course of action. If you don't have a plan, chances are you are going to mess around in the markets, buy a stock here, a bond there, try a tax shelter, trade a piece of real estate-- and ultimately you are probably going to end up with a hodgepodge of gains and losses all adding up to more of a headache than anything else.

I've been writing in this vein for years, and one of the retorts I always get is, "All right, Russell, this planning idea sounds all right. So why don't you tell us how YOU operate? Maybe that will give me the inspiration for a plan of my own." And that sounds fair enough, so at this time I'm going to reveal to subscribers my own philosophy of investing. Remember, this method of operating was tailored by me for me. It may be a good concept for you or it may not be at all. Ideally, you should work out your own philosophy of investing, one that you approve of and one that you are willing to follow--and stick to.

My theory from the very beginning was this: I wanted to build a safe, reliable CASH FLOW from outside my job. Then I would take that cash flow and diversify it into various common stock investments. The first problem was--where would I get the cash flow from? My answer was: any SAFE security with an ATTRACTIVE YIELD. In other words, if it wasn't safe I didn't want it. And if it didn't throw off a good cash return, I wasn't interested.

After careful study, I concluded that treasury bonds, muni bonds, utility stocks and certain high-yielding common stocks such as Exxon, Chevron, Woolworth, etc., would fit my bill for INCOME. Then I would take that income and spread it around in other stocks that would tend to keep up with the Dow. My theory was that initially I had to have safe, guaranteed income in order to give me a definite monthly cash flow. Furthermore, If the economy was static or in a deflationary phase, that steady income would constitute a big plus.

But if the economy was in an inflationary mode, then my other stocks (the ones I purchased with the cash flow from the stodgy, safe securities) would help me keep up with inflation. For the "keep up with the Dow and inflation" issues, I decided that the easiest and probably the most fool-proof way to invest was with closed-end funds. Although I bought many individual stocks, I placed perhaps two-thirds of my cash flow income into closed-end funds.

Subscribers know that over the years I have liked the closed-end funds. These are actually professionally-managed companies whose business is owning stocks in other companies. But unlike an investment in a no-load fund, when you buy a closed-end fund you are simply buying the stock from another investor, exactly the same as when you buy GM you are buying the shares from another investor. Regardless of the net assets of a closed-end fund, the fund is subject to the bid and asked of the market at that particular time (unlike a mutual fund which sells on the basis of its net asssets). Thus, I have seen all the listed closed-end funds sell at a premium above net assets or, at other times (and this is more usual), at a discount from actual net asssets. In a few instances in the past, I have seen the discount to net assets on closed-end funds rise to as high as 40%.

Some of the no-load funds I have bought are Tri-Continental (the largest of the closed-ends with assets of $1.3 billion), Lehman, Adams Express, General Amer. Investors (NYSE). All of these funds pay quarterly dividends plus a once-a-year capital gains supplement. I reinvest all dividends and capital gains payments back into the respective funds.

So to make a long story short, my own investment strategy entails (1) securities that provide a safe, guaranteed cash flow, and (2) reinvestment of that cash flow into stocks of mostly closed-end funds. Ideally (in due time) your investments should act exactly like a SECOND BUSINESS for you, one that is building assets through the years and one that is subject to no expenses except taxes.

At any rate, that has been my method of building assets, and it has worked for me. There is, of course, one vital stipulation (and it is one that I have always adhered to). YOU MUST ALWAYS SPEND LESS THAN YOU MAKE. Which is just another way of saying, YOU MUST SAVE. No savings equals no assets; it's as simple as that. The plan I have described is simply a plan for utilizing one's assets. And it's a plan that has worked very well for me. If you have a better plan, by all means follow it. But don't try to steer me onto your plan. Because I long ago decided that come hell or high water, I was going to STICK with mine.

NEW YORK: Back from the big city after my first real seven-day vacation since 1958 (by that I mean that I gave no speeches--just had fun). We stayed in our favorite hotel, the Regency. Why the Regency? Because it is the most convenient location in the city (61st and Park) and because it has a

fully-equipped gym. The Regency at any given time resembles the United Nations. Downstairs in the Regency lobby you think you're in Munich or Tokyo or Rome, but that's the way NYC is today (wife Faye asked, "Does anyone still speak English in New York?").

It's funny, but when I left New York for California back in 1961 I was scared stiff of the move. I knew I wanted to get out of New York, but one thing scared me above all else. NYC was then (as it is now) the news and communications center of the world, and to leave the city was tantamount to going out into the desert with no water. I was sure I would lose contact with the civilized world once I left Gotham. And for a while, it was as though my worst fears had come true.

But then the Wall Street Journal started publishing nationally. Next, the LA Times began to get very sophisticated and worldly wise. Then the great god, the New York Times, started publishing on the West Coast, as did Barron's. The Christian Science Monitor gave same-day service, and finally USA Today (go ahead, sneer, but I like the paper) offered early morning service.

New York City seems to get more crowded every year (I left back in '61 because it was too crowded!). Below 59th St. one is blinded by a sea of faces, bodies, rushing businessmen, bag ladies, shoppers, black peddlers (they sell umbrellas in the rain, then miraculously switch to sunglasses when the sun comes out, and in between they sell jewelry). The noise level in the city is mind-boggling. Ambulances, fire engines, police sirens, shouting; New Yorkers maintain their sanity by becoming totally immune to noise (and dirt).

Faye and I are big walkers, and this trip was no exception (besides, walking in Gotham often gets you there faster than does a taxi). By the way, most of the taxi drivers are now foreigners and we found out that many of them don't know their way around the city! Our favorite walk -- up Madison Avenue, a long avenue that boasts the finest, the most original and the most fashionable shops in the nation. On Madison one sees art galleries (with real art like half-million dollar Picassos), the latest Italian, Japanese and French clothes, plus restaurants—dozens of them. Eating out is now the No. 1 preoccupation of middle- and upper-class New Yorkers. Some blocks actually boast up to a dozen restaurants. We hear (no kidding) that many Gothamites have turned their seldom-used kitchens into storerooms or studies.

The restaurants of New York are the finest and certainly the most expensive in the nation. I won't list all that we visited, but the best were Aurora, Lutece (one of only two that the NY Times gives four stars), Harry Cipriani's (the current "in" place with absolutely the best chocolate ice cream I have ever tasted), Manhattan Cafe (always good and serving huge portions), Maxwell's Plum (now going West Coast with its Spago-like pizzas and goat cheese).

We hit dozens of art galleries, but I will report that the IBM gallery (it's free) always presents an outstanding exhibit, this time the German Oskar Schlemmer. Free also is the Pace Gallery's great exhibit of Picasso's sketch books. A fabulous exhibit of African photos going back to the late-1800s at the Int. Center for Photography on 94 St. at Fifth.

One night we walked down Broadway (the Great White Way of my boyhood), and I would say Broadway is now about the sleaziest I have ever seen it. Porno theaters dot the landscape along with pushers, dealers, pimps, crazies, tourists, hustlers, you name it. We walked across Times Square (42nd Street, B'way to 8th Ave). Here one can gaze upon the dope scene of the decade. Dealing is out in the open, and even the kids were passing money and dope around with little pretense of secrecy. While we were there the police and the city were advertising a special task force to lower the boom on "crack" (crack is the new highly addictive, smokable form of cocaine and it seems to be sweeping the city). If the new police crackdown had any effect on halting the dope dealing, we didn't see it.

Observations: the disparity between wealth and poverty in NYC is now the widest I have ever seen. Bag ladies and down-and-outers are sleeping in the doorways of Manhattan's finest buildings. Half-alive bodies are flopped on the sidewalks and ignored by all. Beggars and human rag dolls slump down Madison. At the same time, "stretch limos" literally clog the streets, and prices in the better-store windows are as high as the accompanying skyscrapers. Jewelry seems to be the latest craze (besides food) and some of the diamond and watch displays have to be seen to be believed.

All in all, Gotham is the city with too much of everything. Too much glitter, too much pressure, too much money, too many people, too much poverty, too many human wrecks, too much corruption, too much filth. But it's also the city of the best museums, the best food, the best minds, the best newspaper, and the best water (NYC's drinking water is superb--I was almost embarrassed to bathe in it).

But all good things must come to an end. When we got to Kennedy, American Airlines informed us that the plane was having some instrument trouble, and the flight would be three hours late for take-off. So the trip from NYC to San Diego took us 10 hours. "Traveling," I complained to Faye, "is now like Murphy's Law. Whatever can go wrong--does go wrong."

NOTES & QUOTES: President Reagan's popularity, well into his second term, registers over 70% approval from the people. No other president in modern history (the poll was started in 1946) has ever had this kind of popularity. Conclusion: If you think Reagan is on the wrong track, you may be right— but the American people sure don't agree with you.

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I'm reading a fascinating new book on the GRU, Russia's top-secret agency (it is said that the GRU makes the KGB look like an open book). The title of this book is "Inside the Aquarium" by Victor Sulvorov (Macmillan).

* *

Speaking of security, according to the Washington Post Weekly (April 21) the US intelligence budget is 7% to 8% of the entire defense budget, and this includes the CIA, the Defense Intelligence Agency, the National Reconnaissance Office and the National Security Agency. The actual size of the US intelligence budget is classified, but a well informed source says it exceeds $24 billion!

* *

As bad as the economy is in the Southwest, that's how good it is in New England. Housing prices in Boston and nearby have gone through the roof and unemployment in New England is down around 5%. MacDonalds in Boston are now offering workers (who would ordinarily get minimum wages) $5 per hour.

The US farm scene is another matter--and a sad one. In fact, the farm picture is so bad one wonders if it has perhaps hit bottom. John Schnittker (former undersecretary of agriculture) predicts that "a quarter million" of the US's 700,000 full-time commercial farmers will go broke by 1990.....An estimated 135,000 farmers may be denied credit this spring by the Farm Credit System or commercial banks.....It is thought that farm lenders will have to swallow $20 billion in bad farm loans by 1990 .....The Farm Credit System lost $2.7 billion last year and will lose up to $5 billion in 1986.....US farm debt has tripled since the early 1970s and is currently $210 billion, more than the national debts of Brazil, Argentina and Mexico combined. That, then, is the picture for farming USA.

* *

Obviously, the new tax bill is much in the news and much on everyone's mind. In view of this, I thought the following from Elliot Janeway's May 13 "Janeway Letter" was worth pondering. Janeway quotes a warning remark made to him by the great

Speaker of the House, Sam Rayburn: "I've never seen a tax proposal that originated in the Senate survive in the House."

* *

Fast: Darrell Green of the Washington Redskins outran all others in the NFL a few weeks ago, and he thereby won the title of the "NFL's Fastest Man." How fast is he? Converting to yards per second, Green can go 53 yards in 6 seconds. But mull this over: in the same 6 seconds a wild rabbit can run 68 yards. In 6 seconds a thoroughbred racehorse can run 104 yards. And finally, in 6 seconds a cheetah can run 208 yards. Stay out of the zoo, Darrell, you wouldn't have a chance!

* *

On May 18 the New York Times published an interview with Stalin's daughter. She has been in and out of the US and Russia many times, and I would have to label her non-political. Her latest move is out of Russia and back to the US. I thought the interview was extraordinary, and to me it had the ring of truth about it. I reproduce a bit of that interview below:

Q. I know that you don't like to make prophecies. So I won't ask you about what might happen in the Soviet Union. But let me ask you, what do you think Soviet citizens, by and large, would welcome as changes to improve their life?

A. No one, with exception of the privileged class of party bureaucrats, is satisfied today with the conditions of life in the Soviet Union. Neither is Gorbachev, who is trying to bring prosperity by persuading tired people to work even harder.

Life in the countryside and agriculture are in poor shape. Students are still sent to the villages to bring in the harvest. The farm people, unable to find satisfaction in the countryside, have moved to the bloated cities. This is what has made Moscow so large and unrecognizable.

The people cannot be blamed — although city-dwellers resent them — because life on the collective farm has never been accepted by the peasants. They strive to escape it by all means.

Intellectuals and scientists are frustrated by the ignorant party hacks who rule them and who live better than they do. Youngsters are into every trend in pop and rock. They are willing to defect or marry any foreign tourist to get out.

I am not making prophecies but anyone can see that the country needs a profound economic change, that it is in a severe economic deadlock. That is the real reason for all the secrecy about failures, for all the shows about "democracy" and "prosperity," for all the parades, festivals and speeches. All this reflects fear and insecurity of the ruling party. We saw it every day.

We also saw the tremendous growth and accumulation of the military forces, the technology, the educated manpower. Celebrations of the 40th year of victory in World War II took a whole year and stood in strange contrast to statements about peace in the world. The militaristic spirit is taught strongly to the young generation, which is not at all eager to accept it.

The Soviet Army has brought up strong new commanders who are aggressive and ruthless. The ruling party, on the other hand, has not produced strong leaders, its ideologues for a new era.

We saw an extremely strong and modern army and a weak, outdated ruling party. Gorbachev is sincere and serious about his peace initiatives. But are his marshals and generals in agreement with him? Is Gorbachev — an idealist — able to be stronger than they are? I wish him good luck and I sympathize with his efforts — or at least his wishes — to open up Soviet society, to make it more civilized and really democratic.

Only time will show whether he and the others like him will overcome the monsters of bureaucracy, the army and an outdated ideology. I have no answers to these questions, even though after having seen the land of my birth after 18 years, I feel more sad about its fate than ever before. Is it surprising, then, that I have come back to the United States?

* *

Do you wonder what the insider trading scandal is all about? Here's the best explanation I've seen, by Safire in the May 30 New York Times:

> Suppose you work in the mergers and acquisitions department of an investment bank. You're an insider in a dozen deals a year. Trade in those securities? Not on your life — you know how easy it is for computers to trace the trades. But you have two friends in similiar positions in a law firm and another bank, and they know a couple of "arbs."
>
> So the five of you form a ring. You informally swap inside information and buy the stocks of the deals being made by your other ring members. Maybe you find some member of your business school class to be the coordinator, lend him some money, show him the best overseas banks for moving and laundering money.
>
> You think you've beaten the system. But the law has a stretchable arm: swapping insider information, in anticipation of making a profit, may also "operate as a fraud or deceit."
>
> That is the conspiracy I think U.S. Attorney Rudolph Giuliani is attempting to crack right now, with the help of an elite corps of postal inspectors under John Slavinski and his

* *

What do we call this piece from last week's newspaper? Oh well, let's call it the lead-off piece for our "Most Incredible Stories of the Week" Department:

> PHOENIX, Ariz. — A senior Treasury Department official Friday said bankers must do more to prepare for pending restructurings of major debtor countries' loans so that they can be "ready to lend without delay."
>
> David C. Mulford, assistant Treasury secretary for international affairs, said he was "concerned that not enough has been done by commercial banks to assure that when the time comes, they will in fact be ready to lend."
>
> Mulford, who addressed members of the Bankers' Association for Foreign Trade at the group's convention here, said smaller banks apparently have yet to reach agreement with the major banks on how much new loans they should have to extend to the debtor countries. He urged banks "to consider innovative means to keep banks with less exposure [illegible]"

* *

Have you heard the news? Japan is steadily accumulating all the money in the known world as per this AP piece. One depressing observation: US buyers appear to want Japanese cars at ANY price. The recent series of price increases on Japanese cars hasn't made a dent in their sales to the US. Now if Cadillacs could only sell for say $3,000.....

TOKYO, May 27 (AP) — Japan has become the world's largest creditor nation, surpassing Britain and other industrialized nations, the Finance Ministry said in an annual report today.

Finance Minister Noboru Takeshita reported to a Cabinet meeting that Japan's governmental and private assets in other nations at the end of 1985 totaled $437.7 billion, while liabilities amounted to $307.9 billion. That left Japan with net assets of $129.8 billion, almost twice the amount at the end of 1984.

The report said the sharp increase was a result of active investment in United States and other securities.

Major assets abroad included $145.74 billion in portfolio holdings, including stocks and bonds, and $43.97 billion in direct investments, meaning investments in companies and ventures. Private and government loans totaled $70.16 billion and trade credit came to $24.66 billion, it said.

* *

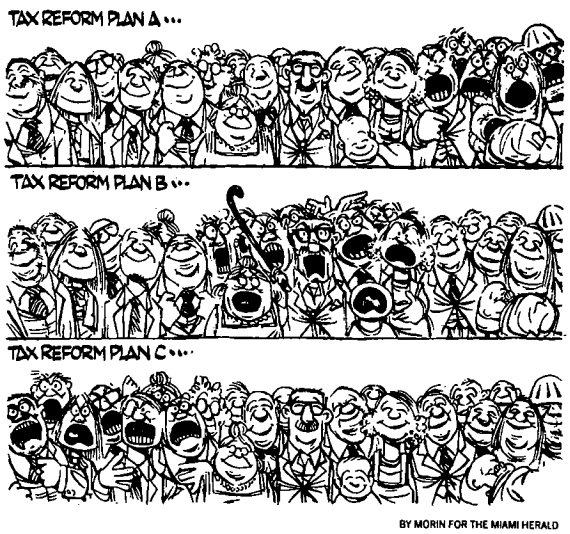
I went to my eye doctor last week, for a new eye check (I've been taking an eye drop called Tinoptic for eye pressure). He told me

that SmithKlein just came out with a new drug which may be even better than Tinoptic. Tinoptic, by the way, has saved many people an eye operation that was formerly used to reduce eye pressure.

The point I want to make is that the drug companies are now coming out with a fantastic array of new drugs, drugs for every conceivable purpose from lowering blood pressure to lowering cholesterol. Medical companies are also coming out with all kinds of new devices, many of which (like new non-invasive methods for checking the heart and arteries) promise to practically revolutionize medicine. So if you wonder why Bristol Myers or Merck or American Home Products are hot stocks-- that's part of the story. The new medical products are just amazing!

* *

This is the best comment I've seen about the new tax bill:



LESSONS: I've often been asked the question, "Russell, how did you learn about the stock market? What books or studies helped you the most?" I've been asked this question so many times that I thought I'd write something here about it.

I would say that two bodies of writing helped me the most. The first was the writing of Robert Rhea. I got hold of a copy of Rhea's "Dow Theory Comment," which was actually Rhea's investment service, from the New York Public Library. These were reports written between 1932 and 1939 (Rhea died in '39). I read those reports and studied them against charts of the daily averages for a period of two solid years. I mean I read Rhea's writings day after day, month after month -- until I thought I was living inside his mind. I would say that nothing I've done in the stock market has ever taught me as much as those studies of Robert Rhea's works. Of course, it helped that Rhea was a genius. He was, in my opinion, the greatest reader of the Averages in stock market history.

The second most valuable lesson I ever received was from the writings of and from my friendship with E. George Schaefer. Schaefer started his "Dow Theory Trader" reports in 1948 out of Indianapolis. This Hoosier gentleman had a feel for the great primary trend of the market that was absolutely uncanny. Schaefer put out a series of what he termed "Technical Studies" that explained how and why he drew his remarkable conclusions about the great 1949-66 bull market. Those reports are classics, and someone really should reprint them.

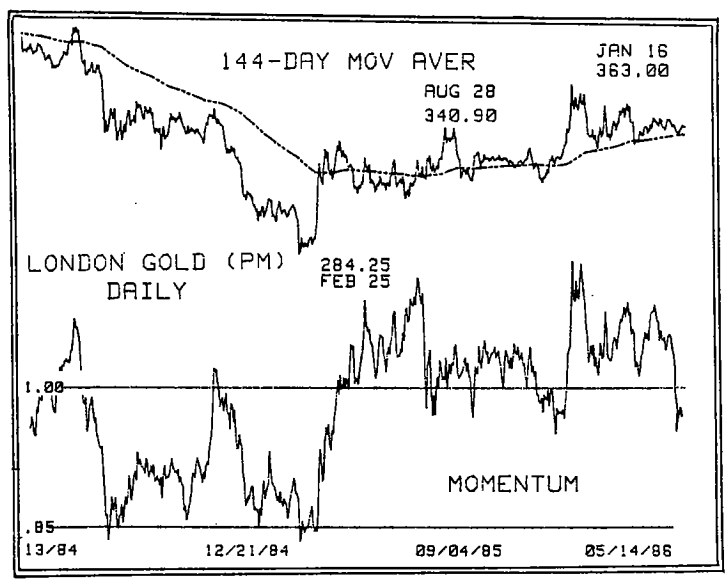
Schaefer called the turn for the great bull market just days after the absolute bottom, a bottom which was recorded on June 13, 1949. He then stayed bullish all the way up to the bull market top, which came in 1966. Those followers who stayed with Schaefer during the 1949-66 years made fortunes. I know that I learned more about the concept of the primary trend from Schaefer than I did from anyone else. And strangely, this primary trend concept (basic as it is) is still the one that eludes most analysts and investors. Yet, it is the concept of the primary trend that is the true fortune-maker in the stock market.

GOLD: People buy gold for the WRONG reasons. Gold isn't a speculation, gold isn't a proxy for a hot new issue or a trip to Vegas. Gold is REAL MONEY. Real money doesn't have debt or liabilties against it. Real money doesn't need some treasury or congress to tell you that it's "legal tender." Real money possesses undeniable value. Real money HOLDS ITS VALUE during market crashes, inflationary wipe-outs, revolutions, government collapses or broad-scale failures in the banking systems.

Yet many, if not most, people buy gold and hold gold for the WRONG reasons. I don't own gold coins with the silent wish that those Krugerrands and Maple Leafs will double and triple in price. Because I know that if those coins start rocketing in terms of dollars, that will be the signal telling me that the dollar and the US economy are going to hell. It will be telling me that hundreds of billions of dollars worth of US debt are sinking, and that foreigners are selling Uncle Sam down the river.

I own gold coins because I don't TOTALLY trust any other investment -- my house, my bonds, my stocks. I hold gold JUST IN CASE. Gold coins are the ONLY investment I DON'T WORRY ABOUT. Because I know that a thousand years from now, my gold coins will still be money. I'd bet on that before I'd bet on anything else in the investment world.

There's been some deterioration in the gold picture (see chart). The gold momentum line has broken down. BUT gold is still holding above its 144-day moving average, which now stands at 338. The gold/common stock ratio has slipped to a new five-year low -- which presents a negative background for the metal. Watch the 336 level for gold. That's the critical level now.



LATE NOTES: It's not an easy call here at all. We've got definite divergence in the Averages (i.e., Dow and the Transports). But it would take a real swoon in the Dow to turn the secondary trend of the market bearish--probably a drop below 1735.51 (which I don't think is likely). Nevertheless, the Dow is currently better than 300 points above its 200-day moving average, and that huge spread puts a STRAIN on the market. Thus, the divergence in the Averages (rather than being a major danger signal) may simply indicate that the market is tired and needs a rest. From a technical standpoint, the best thing this market could do is back and fill (consolidate) for a while. The strength in my PTI continues to be extraordinary. Remember my old rule--as long as the PTI is in a rising trend, the market may hesitate, but it will not go into a serious decline.

NEXT MAILING: June18